

necessary to establish the factors described in paragraph (b)(1) of this section, the taxpayer shall request the employer to furnish the taxpayer with a written statement indicating that the employer will not treat the cancellation of the nonlapse restriction as a compensatory event, and that no deduction will be taken with respect to such cancellation. The taxpayer shall file such written statement with his income tax return for the taxable year in which or with which such cancellation occurs.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

*Example (1).* On November 1, 1971, X corporation whose shares are closely held and not regularly traded, transfers to E, an employee, 100 shares of X corporation stock subject to the condition that, if he desires to dispose of such stock during the period of his employment, he must resell the stock to his employer at its then existing book value. In addition, E or E's estate is obligated to offer to sell the stock at his retirement or death to his employer at its then existing book value. Under these facts and circumstances, the restriction to which the shares of X corporation stock are subject is a nonlapse restriction. Consequently, the fair market value of the X stock is includible in E's gross income as compensation for taxable year 1971. However, in determining the fair market value of the X stock, the book value formula price will ordinarily be regarded as being determinative of such value.

*Example (2).* Assume the facts are the same as in example (1), except that the X stock is subject to the condition that if E desires to dispose of the stock during the period of his employment he must resell the stock to his employer at a multiple of earnings per share that is in this case a reasonable approximation of value at the time of transfer to E. In addition, E or E's estate is obligated to offer to sell the stock at his retirement or death to his employer at the same multiple of earnings. Under these facts and circumstances, the restriction to which the X corporation stock is subject is a nonlapse restriction. Consequently, the fair market value of the X stock is includible in E's gross income for taxable year 1971. However, in determining the fair market value of the X stock, the multiple-of-earnings formula price will ordinarily be regarded as determinative of such value.

*Example (3).* On January 4, 1971, X corporation transfers to E, an employee, 100 shares of stock in X corporation. Each such share of stock is subject to an agreement between X and E whereby E agrees that such shares are

to be held solely for investment purposes and not for resale (a so-called investment letter restriction). E's rights in such stock are substantially vested upon transfer, causing the fair market value of each share of X corporation stock to be includible in E's gross income as compensation for taxable year 1971. Since such an investment letter restriction does not constitute a nonlapse restriction, in determining the fair market value of each share, the investment letter restriction is disregarded.

*Example (4).* On September 1, 1971, X corporation transfers to B, an independent contractor, 500 shares of common stock in X corporation in exchange for B's agreement to provide services in the construction of an office building on property owned by X corporation. X corporation has 100 shares of preferred stock outstanding and an additional 500 shares of common stock outstanding. The preferred stock has a liquidation value of \$1,000x, which is equal to the value of all assets owned by X. Therefore, the book value of the common stock in X corporation is \$0. Under the terms of the transfer, if B wishes to dispose of the stock, B must offer to sell the stock to X for 150 percent of the then existing book value of B's common stock. The stock is also subject to a substantial risk of forfeiture until B performs the agreed-upon services. B makes a timely election under section 83(b) to include the value of the stock in gross income in 1971. Under these facts and circumstances, the restriction to which the shares of X corporation common stock are subject is a nonlapse restriction. In determining the fair market value of the X common stock at the time of transfer, the book value formula price would ordinarily be regarded as determinative of such value. However, the fair market value of X common stock at the time of transfer, subject to the book value restriction, is greater than \$0 since B was willing to agree to provide valuable personal services in exchange for the stock. In determining the fair market value of the stock, the expected book value after construction of the office building would be given great weight. The likelihood of completion of construction would be a factor in determining the expected book value after completion of construction.

[T.D. 7554, 43 FR 31918, July 24, 1978]

#### § 1.83-6 Deduction by employer.

(a) *Allowance of deduction—(1) General Rule.* In the case of a transfer of property in connection with the performance of services, or a compensatory cancellation of a nonlapse restriction described in section 83(d) and § 1.83-5, a deduction is allowable under section 162 or 212 to the person for whom the services were performed. The amount

of the deduction is equal to the amount included as compensation in the gross income of the service provider under section 83 (a), (b), or (d)(2), but only to the extent the amount meets the requirements of section 162 or 212 and the regulations thereunder. The deduction is allowed only for the taxable year of that person in which or with which ends the taxable year of the service provider in which the amount is included as compensation. For purposes of this paragraph, any amount excluded from gross income under section 79 or section 101(b) or subchapter N is considered to have been included in gross income.

(2) *Special Rule.* For purposes of paragraph (a)(1) of this section, the service provider is deemed to have included the amount as compensation in gross income if the person for whom the services were performed satisfies in a timely manner all requirements of section 6041 or section 6041A, and the regulations thereunder, with respect to that amount of compensation. For purposes of the preceding sentence, whether a person for whom services were performed satisfies all requirements of section 6041 or section 6041A, and the regulations thereunder, is determined without regard to § 1.6041-3(c) (exception for payments to corporations). In the case of a disqualifying disposition of stock described in section 421(b), an employer that otherwise satisfies all requirements of section 6041 and the regulations thereunder will be considered to have done so timely for purposes of this paragraph (a)(2) if Form W-2 or Form W-2c, as appropriate, is furnished to the employee or former employee, and is filed with the federal government, on or before the date on which the employer files the tax return claiming the deduction relating to the disqualifying disposition.

(3) *Exceptions.* Where property is substantially vested upon transfer, the deduction shall be allowed to such person in accordance with his method of accounting (in conformity with sections 446 and 461). In the case of a transfer to an employee benefit plan described in § 1.162-10(a) or a transfer to an employees' trust or annuity plan described in section 404(a)(5) and the regulations

thereunder, section 83(h) and this section do not apply.

(4) *Capital expenditure, etc.* No deduction is allowed under section 83(h) to the extent that the transfer of property constitutes a capital expenditure, an item of deferred expense, or an amount properly includible in the value of inventory items. In the case of a capital expenditure, for example, the basis of the property to which such capital expenditure relates shall be increased at the same time and to the same extent as any amount includible in the employee's gross income in respect of such transfer. Thus, for example, no deduction is allowed to a corporation in respect of a transfer of its stock to a promoter upon its organization, notwithstanding that such promoter must include the value of such stock in his gross income in accordance with the rules under section 83.

(5) *Effective date.* Paragraphs (a)(1) and (2) of this section apply to deductions for taxable years beginning on or after January 1, 1995. However, taxpayers may also apply paragraphs (a)(1) and (2) of this section when claiming deductions for taxable years beginning before that date if the claims are not barred by the statute of limitations. Paragraphs (a) (3) and (4) of this section are effective as set forth in § 1.83-8(b).

(b) *Recognition of gain or loss.* Except as provided in section 1032, at the time of a transfer of property in connection with the performance of services the transferor recognizes gain to the extent that the transferor receives an amount that exceeds the transferor's basis in the property. In addition, at the time a deduction is allowed under section 83(h) and paragraph (a) of this section, gain or loss is recognized to the extent of the difference between (1) the sum of the amount paid plus the amount allowed as a deduction under section 83(h), and (2) the sum of the taxpayer's basis in the property plus any amount recognized pursuant to the previous sentence.

(c) *Forfeitures.* If, under section 83(h) and paragraph (a) of this section, a deduction, an increase in basis, or a reduction of gross income was allowable (disregarding the reasonableness of the amount of compensation) in respect of

a transfer of property and such property is subsequently forfeited, the amount of such deduction, increase in basis or reduction of gross income shall be includible in the gross income of the person to whom it was allowable for the taxable year of forfeiture. The basis of such property in the hands of the person to whom it is forfeited shall include any such amount includible in the gross income of such person, as well as any amount such person pays upon forfeiture.

(d) *Special rules for transfers by shareholders*—(1) *Transfers*. If a shareholder of a corporation transfers property to an employee of such corporation or to an independent contractor (or to a beneficiary thereof), in consideration of services performed for the corporation, the transaction shall be considered to be a contribution of such property to the capital of such corporation by the shareholder, and immediately thereafter a transfer of such property by the corporation to the employee or independent contractor under paragraphs (a) and (b) of this section. For purposes of this (1), such a transfer will be considered to be in consideration for services performed for the corporation if either the property transferred is substantially nonvested at the time of transfer or an amount is includible in the gross income of the employee or independent contractor at the time of transfer under § 1.83-1(a)(1) or § 1.83-2(a). In the case of such a transfer, any money or other property paid to the shareholder for such stock shall be considered to be paid to the corporation and transferred immediately thereafter by the corporation to the shareholder as a distribution to which section 302 applies.

(2) *Forfeiture*. If, following a transaction described in paragraph (d)(1) of this section, the transferred property is forfeited to the shareholder, paragraph (c) of this section shall apply both with respect to the shareholder and with respect to the corporation. In addition, the corporation shall in the taxable year of forfeiture be allowed a loss (or realize a gain) to offset any gain (or loss) realized under paragraph (b) of this section. For example, if a shareholder transfers property to an employee of the corporation as compensa-

tion, and as a result the shareholder's basis of \$200x in such property is allocated to his stock in such corporation and such corporation recognizes a short-term capital gain of \$800x, and is allowed a deduction of \$1,000x on such transfer, upon a subsequent forfeiture of the property to the shareholder, the shareholder shall take \$200x into gross income, and the corporation shall take \$1,000x into gross income and be allowed a short-term capital loss of \$800x.

(e) *Options*. [Reserved]

(f) *Reporting requirements*. [Reserved]

[T.D. 7554, 43 FR 31919, July 24, 1978, as amended by T.D. 8599, July 19, 1995]

#### **§ 1.83-7 Taxation of nonqualified stock options.**

(a) *In general*. If there is granted to an employee or independent contractor (or beneficiary thereof) in connection with the performance of services, an option to which section 421 (relating generally to certain qualified and other options) does not apply, section 83(a) shall apply to such grant if the option has a readily ascertainable fair market value (determined in accordance with paragraph (b) of this section) at the time the option is granted. The person who performed such services realizes compensation upon such grant at the time and in the amount determined under section 83(a). If section 83(a) does not apply to the grant of such an option because the option does not have a readily ascertainable fair market value at the time of grant, sections 83(a) and 83(b) shall apply at the time the option is exercised or otherwise disposed of, even though the fair market value of such option may have become readily ascertainable before such time. If the option is exercised, sections 83(a) and 83(b) apply to the transfer of property pursuant to such exercise, and the employee or independent contractor realizes compensation upon such transfer at the time and in the amount determined under section 83(a) or 83(b). If the option is sold or otherwise disposed of in an arm's length transaction, sections 83(a) and 83(b) apply to the transfer of money or other property received in the same manner as sections 83(a) and 83(b) would have applied to the transfer of property pursuant to an exercise of the option.